

BANK-INSURANCE VIABILITY INDEX

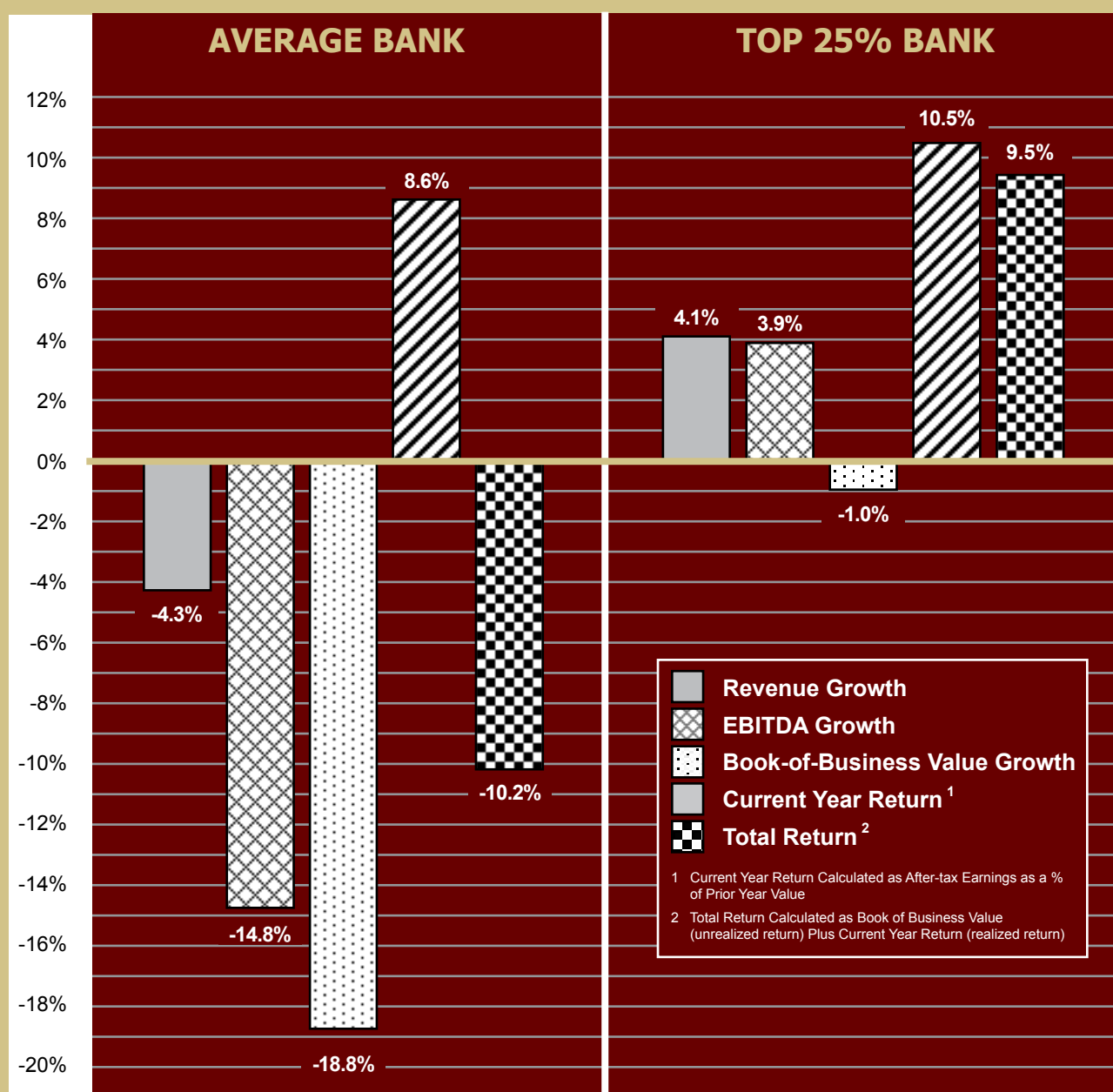
Reality Check: Bank-Agency Returns

The rate environment and the economic recession have severely impacted top line growth and agency value during the past 18 months. For the twelve months ending 6/30/09, the average total return on prior year value of a bank-owned insurance agency was a negative 10.2%. While total revenue slipped only 4.3%, the value of the intangible assets ("book-of-business value") declined by 18.8% primarily due to a drop in earnings. While a decline in the average EBITDA multiple paid had an impact, average EBITDA itself declined by a sizable 14.8%. A drop in value of 18.8% plus average earnings for the year as a percentage of last year's value of 8.6% provides a total estimated return of negative 10.2%.

For most agencies, value deflation was impacted by a steep reduction in "other income" (contingent income, supplemental income and investment income). The key difference between the best and the worst, however, was a direct result of poor management. Over the past 24 months, many bank-owned agencies have implemented short-term cost saving initiatives in hopes of preserving profitability, but instead destroyed organic growth and long-term sustainability. Servicing staff hiring freezes, wage freezes and a moratorium on producer reinvestment were implemented in order to improve short-term margin. However, this strategy has instead set the table for cascading impairment. Despite these initiatives, profitability slipped due to revenues declining faster than expenses could be cut. To add insult to injury, banks have increasingly been reluctant to deploy capital for acquisition which is a key outlet for securing talent and niche specialties.

Bank-Insurance Value Change

6/30/08 - 6/30/09



Within peak performing bank-owned agencies, total return was preserved by revenue and EBITDA growth despite decreasing EBITDA multiples. A decrease in the book of business value was held to a mere 1% by increasing revenue and EBITDA through consistent and well-defined new business production, producer accountability, reinvestment and acquisition. Total return on prior year value averaged 9.5%. Peak performers were able to outrun the market and the economy through execution of a well-defined operating and organic growth plan. Over 78% maintain and enforce minimum sales expectations with compensation ramifications for the sales staff while 67% mandate pipeline management system utilization. Additionally, peak performing bank-owned agencies have cranked down on expense ratios. But, this strategy was coupled with 1) service staff player trades versus wage / hiring freezes; 2) consistent reinvestment in next generation production staff; 3) producer accountability; and 4) strategic acquisitions.

Most bank board meetings have been filled with discussions about "going back to core", questioning both the long-term viability and strategic fit of banks in insurance. Ironically, those that have ceased watering the flower have created a self fulfilling prophecy of continued impairment and inevitable divestiture. Those banks that have nurtured, watered and fertilized overwhelmingly believe that insurance provides one of the best, if not the best, risk adjusted return on capital (RAROC) in the entire bank. The minority that have executed a long-term sustainability plan wholeheartedly support insurance expansion.

Folks, the real assets of an insurance agency walk out the front door every single night. Once the spigot turns off and it is visible to the entire staff that the parent is not supporting growth and opportunity, poor performance is followed by key employee and account attrition which is then followed by a mass exodus. The harsh reality is that banks that are implementing a short-term business plan to try to preserve margin without a strategy to maximize long-term value appreciation are managing an asset that is becoming impaired at an exponential rate.

Leading banks will continue to deploy capital, drive growth, embrace accountability and realize long-term equity enhancement within the bank-owned insurance agency. The top 25% of bank-owned insurance agencies are performing well, despite the external environment and will continue to reinvest and thrive. Those banks that are choking the life out of their insurance subsidiary will do just that.

